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summaries

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Defense Wins Championships

A well respected hockey coach of mine used to say that offense makes the highlight reels, but defense wins championships. Maybe I clung to this advice because I was a defenseman. I was lousy at putting the puck in the opponent's net, but I was particularly good at keeping it out of our net.

Growing up playing hockey in Michigan throughout the 90's, I had the chance to see first hand how an exceptional defensive effort can be critical to the success of a team. Nicklas Lidstrom played for the Detroit Red Wings for 20 seasons from 1991-2012. During that period he was voted the best defenseman in the league seven times, won four Stanley cups, never missed the playoffs and had a career +/- rating of +450. A player receives a "plus" when they are on the ice and their team scores. They receive a "minus" when they are on the ice and the other team scores. In my opinion, +/- is a better measure of a player's true value, over and above how many goals and assists they've produced. A career +/- mark of +450 is astonishing.

More recently, Super Bowl XLVIII was a perfect example of a team's defense dominating a game, as the Seattle Seahawks limited Peyton Manning and the league-leading Denver Broncos offense to just eight points. Although the Seahawks put up 43 points of their own, they theoretically could have won the game using only their first nine.

An article titled "Does Defense Really Win Championships?" appeared on www.freakonomics.com in January 2012, looking to either prove or dispel one of my favorite sports-related quotes. In this case they focused solely on football. Using a database of more than 10,000 NFL regular season games, the author concluded that the higher ranked defense won 66.5 percent of the time, while the higher ranked offense won 67.4 percent of the time. The article concludes that coming at the opponent with a strong offense and a strong defense is probably your best bet. So maybe my love for defense is a bit overstated. I will still argue, however, that a strong defense is more likely to go unnoticed or be underappreciated when compared to a strong offense. After all, the highlight reels seem to be loaded with goals, touchdowns, homeruns and dunks.

So what does defense have to do with personal finance? Perhaps more than the average person thinks.

Over the past few years, I've spent a fair amount of time meeting with the offspring of Sigma clients. As one might suspect, a large portion of our client base consists of baby boomers in their 50's and 60's. Their children are graduating from college, buying houses, getting married, having kids and charting their own path. I love these meetings, as it gives me a chance to sit down with my peers to discuss many aspects of personal finance.

summaries

Oftentimes our meetings will consist of broad, open-ended discussions about building wealth. In financial terms, the ability to accumulate wealth and achieve financial independence over time is solely a function of having more money coming in than going out. In sports terms, bringing money in is your offense, while limiting what goes out is your defense.

The Millionaire Next Door: The Surprising Secrets of America's Wealthy, by Thomas Stanly and William Danko is one of my favorite personal finance books. Originally published in 1996, this book is an amalgamation of data and stories relating to individuals who have been particularly adept at building and maintaining wealth. While some of the data points in the book are outdated (i.e. income and spending numbers for America's affluent that are almost 20 years old), the conceptual knowledge presented is timeless.

The book was written after the authors collected 20 years of data from more than 1,000 individuals with a net worth of more than $1 million. To their astonishment, they came to realize a general rule of thumb: Many people who live in exquisite homes and drive luxury cars do not have much accumulated wealth on average. They also discovered something even more surprising: Many people who have been prodigious accumulators of wealth tend not to live in exquisite homes and drive luxury cars.

In short, Americans who are particularly adept at building and maintaining personal wealth play great defense. If their financial lives were a hockey game, they would be carrying a Lidstrom-esque career +/-. According to Mint.com, less than one third of Americans track their income and expenses on a regular basis. Fewer still are the number of Americans who outline long-term savings and investment goals for themselves. After all, tracking income and expenses in conjunction with setting and monitoring investment goals can be quite time consuming. Further, Stanley and Danko argued back in 1996 (and I believe that it still holds true today) that it is much easier to make money in America than it is to accumulate wealth. In other words, the average American consumer assumes that if their offense is good enough (if they can keep making money), then playing defense by budgeting is unnecessary.

I used to dread the thought of having to dig through multiple credit card and bank statements in order to get a sense of how much was coming in and going out on a monthly basis. As long as my checking account was going up, I was a net saver.

However, as things got more complex over time, I needed something better. I decided to sign up for a free Mint.com account. Mint is a secure website that is able to track income and spending, spotting trends and allowing users to set specific goals. This budgeting application now sits at the center of my thought process when it comes to my own financial planning. It also drives many of the conversations that I have with the grown offspring of clients. There are other budgeting applications that are available, such as Quicken, HomeBudget and iWallet, although I have less experience with these Mint alternatives.

Now, at the click of a button, those of us in our 20's who were previously too busy to set and follow a budget can have one. There really is no excuse for playing bad defense. How much is being spent at the bar on a monthly basis? What about restaurants, cable TV, cell phones, groceries, clothes and gas?

Technology can make the budgeting process and thus playing defense much easier than it used to be. However, there are still a few key steps that I like to focus on and give extra attention to.

Pay yourself first: I talk to a lot of young people who have angst related to how much they should be putting into their 401(k) plan at work. Of course it makes sense to put enough to get the full matching contribution. However, many people struggle with how much more they could or should be contributing. When I started at Sigma I asked the same question of my boss, Bob Bilkie. The number that he suggested caused me to just about fall over. But I took the advice and I'm glad that I did. When I'm meeting with clients in their 20's and 30's, my suggestion is to save as much as they can. If their retirement contribution turns out to be too much of a burden it can always be adjusted. I can't recall one situation where this ended up being the case.

Expect the unexpected: You may have a pretty good idea of how much it costs to run your household on a monthly basis, but there are sure to be months where things get lumpy. Plan for the worst and hope for the best. I take great comfort in knowing that I could pay to replace a broken furnace in the middle of January if I had to. If I hit a pothole on the way to work, having to buy a new tire isn't going to sink the ship, because it all fits into the budget. Having an emergency fund is one of the most comforting things that an individual can give themselves in a world of uncertainty. Make sure to put emergency dollars aside every month, even if you don't anticipate a short-term liquidity need.

Review results regularly: I make it a point to sit down and review my results after the last day of the month. December's results were acutely painful after accounting for the holidays and 3 weddings, while January was decidedly better. I also tend to catch things during my monthly review that are no longer necessary. As an example, I recently caught a $50 antivirus automatic subscription renewal for a laptop that I no longer own.

Be willing to adjust: A budget should serve as a guideline, but it shouldn't be written in stone. Major life milestones may require adjustments to the budget and that's perfectly alright. Planning on getting married, buying a home or having a baby? These are all life events that can be built into a budget so that surprises can be kept to a minimum.

Be consistent: Budgeting can be very similar to signing up for a gym membership in January. Everybody has a renewed sense of purpose as they attack their workouts seven days a week with the intensity of an Olympic hopeful. By the time February rolls around their aggressive plan has lost its luster. By setting realistic goals and expectations, the chances of burning out are reduced while the chances of succeeding increase greatly. This goes for fitness along with budgeting.

Spend your spending money: Budgets are most often used to protect against overspending, but they can also be used to drive spending behavior in the opposite direction. For those who never spend money on themselves, it can make a lot of sense to earmark a certain amount per month for guilty pleasures. If you get to the end of the month and you haven't spent your guilty pleasure allotment, make a point of doing so.

Playing good defense is just one trait that successful accumulators of wealth exhibit. For those who are interested in some of the others, I would strongly suggest reading The Millionaire Next Door. I find this book to be especially applicable for younger individuals who are interested in establishing good lifelong money habits.

In sports and in personal wealth accumulation, it seems that those who are armed with a potent offense or high income tend to get much of the attention. However, a high scoring offense doesn't mean much if your defense can't provide the necessary support.

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